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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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More Monetary Policy Ease . . .

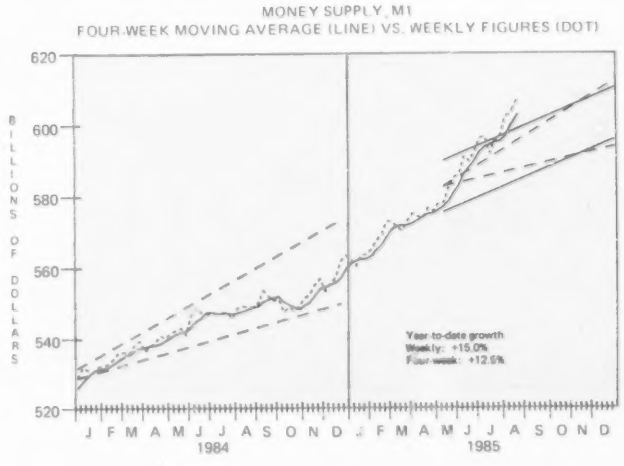
Now that August's meeting of the Federal Reserve's policy-setting Federal Open Market Committee is over, speculation abounds again as to the near-term course of monetary policy. But despite some doubts that the Fed will maintain its accommodative stance due to overly rapid M1 money supply growth, the fact remains that as long as the pace of business remains listless, and inflation rates so modest, not only should monetary poiicy remain accommodative, but may ultimately turn even easier still. Thus, the Fed may soon set the stage for both lower interest rates and as a by-product, a lower-valued dollar in the foreign exchange markets—developments which could provide a much needed lift to the hard-pressed manufacturing sector of the economy.

One reason for expecting such a move is that recent business statistics largely paint a picture of relative weakness. Domestic auto sales slumped in July to their lowest monthly rate since last November, while retail sales in general rose only modestly during the month. On the goods-producing side of the economy too, there are few signs to suggest that a rebound looms anytime soon. Industrial production barely edged higher in July when compared with month-earlier levels, and capacity utilization economy-wide was unchanged; add to this the fact that factory orders and manufacturing employment are also heading lower, and it appears a good bet that at the very least the third quarter got off to a lackluster start.

On the other hand, trends in M1 money supply growth have prompted increasing doubts that monetary policy would be eased. The ongoing rise of M1 in recent weeks strengthens the argument of those urging less rather than more accommodation—it is now nearly $11 billion above the new upper target boundary set just eight weeks ago, and so far this year has expanded at a hefty 15 percent annual clip (see chart). Even though the Fed claims it is not as concerned about the rapid growth of M1 as it has been in the past—possibly in light of the slower growth rates of both M2 and M3—it still remains to be seen whether or not the Fed eventually takes steps to lean against the existing money supply bulge.

. . . Could Be In The Offing

In fact, it may already have. It now appears that the central bank has decided to slow the provision of reserves to the banking system—prompting some upward drift in the key Federal funds rate. Whereas total reserves have risen at an almost 18 percent annual rate clip over the past 13 weeks, in the last month alone, this growth has decelerated—to a less than nine percent annual growth rate. The rapid growth of these building blocks of the money supply could result in even more rapid M1 growth in the future and, while recent actions probably do not presage any major switch in policy, it does suggest that the Fed is now taking a closer look at the money numbers.



But for those charting the course of monetary policy, the fact remains that despite lower interest rates, the economy is still growing only very slowly. At the same time, with inflation rates remaining under control and the dollar's strength still harming domestic manufacturers, it appears difficult to justify any monetary policy tightening. On the other hand, with M1 money growth far above original intentions, the Fed may be wary of loosening the reins further. While a good chunk of this growth is accounted for by an upsurge in interest-bearing checking accounts—and could reflect simply the narrowing of yield differentials between these accounts, a part of M1, and the money market

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funds, included in M2—such a rapid buildup of liquid funds could prove troublesome in the future. The result: Put further easing initiatives on hold for now, but move toward greater accommodation if August's business statistics are as weak as those of July.

A Still Strong Dollar Hurts Exports

Although any further easing of monetary policy, and resulting lower interest rates, could cause the dollar to weaken further, it is unlikely that this will benefit U.S. manufacturers anytime soon. In the U.S. market, prices of imports did not decline in step with the appreciation of the dollar. This allowed foreign producers to fatten their profit margins (in terms of their own currencies) and at the same time set competitive prices which U.S. producers found hard to match. In the period between the end of 1980, when the dollar began its explosive rise, and the end of the second quarter of this year, the dollar appreciated by 62 percent on a trade-weighted basis. However, the index of merchandise import prices fell by only about seven percent. Consequently, there is still an ample profit margin which can be allowed to erode before foreign exporters to the United States market feel competitive pressures.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	8/28/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	177.166	– .071	+18.881
Loans to Depository Inst.	1.096	+ .017	– 7.260
Float	.041	– .512	– .065
Total Reserve Bank Credit	189.788	– .261	+15.417
Treasury Deposits with Federal Reserve Banks	2.436	– .746	– 1.179
Currency in Circulation	187.245	– .657	+11.798
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	124.059	– .741	+ 5.129
	8/28/85		
Member Bank Reserves:			
Total Reserves Held	42.290	– .393	+ 4.986
Excess (Deficiency)	.784	+ .033	+ .107
Net Free Reserves	.306	+ .036	+ .590

		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1	(8/12/85)	603.1	+ 15.6‡	+ 9.5‡
M2	(July '85)	2,490.4	+ 10.4	+ 9.2
M3	(July '85)	3,113.8	+ 7.5	+ 8.8
Domestic Nonfinancial Debt (1st Q'85)		6,147.0	+ 11.3	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 8/30/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.13%	7.29%	7.46%
* Federal Agencies	7.22	7.79	8.60
* Municipal Notes–High Grade (46% Taxable Equivalent)	8.79	9.26	9.72
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market–Prime	7.75	7.85	8.15

‡Finance Company Paper–Prime

5- 14 days	7.70%
15- 29 days	7.70
30- 59 days	7.70
60- 89 days	7.70
90-179 days	7.70
180-239 days	7.70
240-270 days	7.70

‡* Bankers' Acceptances

Sep.	7.66%
Oct.	7.66
Nov.	7.65
Dec.	7.65
Jan.	7.65
Feb.	7.65

‡Industrial Paper–Prime

30- 89 days	7.68%
90-120 days	7.65

†Federal Funds Effective Rate 7.70%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85	$ 3,855r	$ 3,811	$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85	$ 1,672r	$ 1,664	$ 1,639
Percent Change, Annual Rate	2nd Q'85	2.0r	0.3	7.1
Change in Consumer Prices*	Jul '85n	2.4%	2.4%	3.6%
Change in Producer Prices*	Jul '85	3.6%	– 2.4%	2.4%
Civilian Employment (Thousands of Persons)†	Jul '85	106,862	106,370	105,377
Unemployment as % of Civilian Labor Force†	Jul '85	7.3%	7.3%	7.5%
Personal Income*	Jul '85a	$ 3,189	$ 3,176r	$ 3,028
Leading Indicators Composite Index (1967=100)†	Jul '85n	168.7	168.0r	163.9
Industrial Production Index (1977=100) †	Jul '85	124.9	124.7	123.2
Net Change in Consumer Installment Credit †	Jun '85	$ 6.79	$ 9.04	$ 7.08
U.S. Merchandise Trade Balance †	Jul '85n	–$ 10.51	–$ 13.42	–$ 13.77
Plant and Equipment Expenditures*	3rd Q'85	$392.61(a)	$385.31(a)	$361.12
Private Housing Starts (Thousands of Units)*	Jul '85	1,654	1,694	1,730
New Construction Expenditures*	Jun '85	$ 342.8	$ 340.5	$ 317.8
Total Business Inventories †	Jun '85	$ 580.1	$ 577.8	$ 552.4
Total Business Sales †	Jun '85	$ 419.2	$ 428.3	$ 414.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

A similar picture emerges with regard to U.S. exports. As the dollar skyrocketed over the past four and one-half years, the merchandise trade deficit widened from $25½ billion in 1980 to an estimated $140 billion this year. In the same period, the volume of U.S. exports has fallen by 15 percent (while imports have risen by 57 percent). In spite of the 16 percent decline in the trade-weighted value of the dollar since it reached its record high at the end of February, U.S. exports have not yet shown significant improvement. Indeed, in each of the last six months, the value of U.S. exports has been below January's level.

What is more, the structure of U.S. manufactured goods exports is oriented towards such high-value, high-technology capital goods as aircraft and computers, which are frequently ordered well in advance of delivery. This means that a fall in the dollar will be reflected in improved export performance only after a long delay. Add to this the slow pace of economic growth in most other industrialized countries, as well as the continuing financial difficulties of some of our developing country trading partners, and it appears that U.S. export growth will be limited in the immediate future even if the dollar moves lower still. ■

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (8/14/85)	155,430	+ 807	– 3,459
New York City (8/21/85)	32,525	– 9	– 2,622
Commercial Paper (8/21/85)	272,011	+ 414	+52,277

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/14/85)	251,795	– 1,106	+ 5,982
New York City (8/21/85)	59,770	– 100	– 4,312

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/14/85)	679,119	– 1,110	+ 53,650
New York City (8/21/85)	153,243	+ 4,765	+ 16,131

Financial Markets

	Friday 8/30/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.36%	+ .12	– 3.69
180-Day Bills†	7.67	+ .13	– 3.80
Longest Bills†	8.01	+ .12	– 3.88
Recent Issues:			
8⅞s 7/31/87	8.96	+ .10	
9⅝s 6/30/89	9.57	+ .14	
10½s 8/15/95	10.28	+ .15	
10⅝s 8/15/15	10.48	+ .06	
Municipals:			
Bond Buyer–20 Bond Index* (8/29/85)	9.09%	– .09	– 1.08
Blue List Total ($ Million)	$1,779	–$ 166	+ $ 109
30-Day Visible Supply ($ Million)	$3,516	–$1,188	+ $ 87
Total	$5,295	–$1,354	+ $ 196
Corporates:			
Moody's Aa Composite (8/29/85)	11.30%	– .07	– 2.16
30-Day Visible Supply ($ Million)	$2,640	–$ 160	+ $2,140
Stocks:			
Dow-Jones Averages:			
Industrials	1,334.01	+ 15.69	+ 109.63
Transportation	690.66	+ 3.86	+ 170.15
Utilities	159.67	+ .46	+ 30.21
65 Stocks	554.37	+ 4.83	+ 80.38
Standard and Poor's 500 Stocks	188.63	+ 1.46	+ 21.12
N.Y.S.E. Composite Index	109.39	+ .90	+ 13.53
N.Y.S.E. Avg. Daily Vol. for Week (000's)	81,708	– 2,274	+ 12,214

* 46% Taxable equivalent 16.83%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 8/30/85	Week Ago
Overnight	7.63%	7.63%
1 month	7.88	7.81
3 month	8.00	7.94
6 month	8.13	8.13
1 year	8.50	8.50
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	9.90%	10.00%
Long Term (7 to 15 yrs.)	10.40	10.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (8/30/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01774	56.3800
Canada	.7335	1.3634
Denmark	.09872	10.1300
France	.1176	8.5025
Germany	.3595	2.7820
Italy	.0005352	1868.50
Japan	.004221	236.90
Mexico	.002954	338.50
Netherlands	.3193	3.1318
Switzerland	.4377	2.2848
U.K.	1.3995	.7145

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